STOCKS | FUNDS | INVESTMENT TRUSTS | PENSIONS AND SAVINGS

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SHARES

WE MAKE INVESTING EASIER

INCOME ALERT

WILL CAR INSURERS PUT THE BRAKES ON BIG DIVIDENDS?

PLUS

VODAFONE **CUTS ITS DIVIDEND** BACK TO 2009 LEVELS

FINDING THE **BEST RETURN** ON CASH WITH MINIMAL RISK

HOW TO SPOT THE **BEST MULTI-ASSET FUNDS**

Why aren't investors buying stocks with 9% yields?

Investors have fallen out of love with the big income names

The market seems to be fed up with many of the classic high yield stocks on the London market. Once-popular income plays like **Centrica (CNA)**, **Imperial Brands (IMB)** and **Royal Mail (RMG)** continue to fall in value despite offering very attractive dividend yields.

There used to be an argument that high yields from large cap companies would create a theoretical floor for the share price. Put simply, a share price could stop falling once the yield becomes really attractive, such as 6% or more, because investors would mop up the stock in the search for income.

The theory is no longer playing out. Imperial Brands, for example, is now yielding 9.5%. Historically this stock would have been attractive to investors on a yield above 6%. The yield has continued to rise as the share price keeps falling. Year-to-date Imperial Brands is down 9.2%. Over the past 12 months the fall is even worse at 22%.

Very high dividend yields tend to be a signal that the market has doubts over earnings forecasts, financial health or dividend estimates. The falling share price is a reflection of these concerns which results in a rising yield.

So are income investors simply looking elsewhere? The aforementioned companies, as well as the likes of **BT (BT.A)**, **ITV (ITV)**, **British American Tobacco (BATS)** and **Saga (SAGA)** which are all yielding above 7%, all have various hurdles to clear in terms of managing investment in their business and achieving earnings growth.

Vodafone's (VOD) shares have been falling for some time on market worries about the sustainability of its dividend given hefty levels of debt and future investment requirements. The decision to cut the dividend on 14 May failed to win over investors with the stock falling once again.

Another reason why certain income stocks are no longer popular is competition from faster-growing companies which now pay dividends, according to Premier Asset Management fund manager Jake Robbins. 'Investors are capitulating with many traditional income stocks as they can't stomach the capital losses,' he remarks.

'Sectors with questions about future growth are struggling and investors are now able to get income elsewhere from higher-growth stocks. While yields may only be 2% to 3%, some are growing dividends by up to 15% or 20% a year which means your income is inflation-proofed,' adds the fund manager.

Although Robbins looks globally for ideas, if you apply his theory to the UK market we find six examples of stocks offering both earnings and dividend growth, and their shares have been rising this year (see table).

You would need to do more research on valuation and sustainability of dividends before thinking about buying any of these shares.

We plan to look at the state of FTSE 100 dividend yields in more detail in next week's *Shares*.

Name	Yield	Pre-tax profit growth	Divi growth	Share price year-to-date
Bank of Georgia	6.1%	11.5%	19.2%	22.2%
Integrated Diagnostic	5.3%	24.0%	20.4%	16.3%
Tesco	3.9%	10.8%	13.4%	27.0%
B&M	3.1%	14.9%	47.5%	37.3%
4Imprint	2.5%	12.8%	12.4%	43.4%
Coca-Cola HBC	2.3%	12.0%	13.3%	11.4%

Source: SharePad, as of 14 May 2019. Growth and yield figures based on 2nd year forecasts

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In Japan you need to look past the noise.

LET'S TALK HOW.

FIDELITY JAPAN TRUST PLC

With over 3,500 listed companies, there's a lot of financial noise on the streets of Japan. That can be deafening to untrained ears.

Through a hands-on research process, Nicholas Price and our team of analysts hone in on stocks with something to shout about that haven't been picked up by other investors. These opportunities are often found in smaller and medium-sized companies not frequently visited by analysts, although they could also be found in other areas of the market.

PAST PERFORMANCE

	Apr 14 – Apr 15	Apr 15 – Apr 16	Apr 16 – Apr 17	Apr 17 – Apr 18	Apr 18 – Apr 19
Net asset value	**28.5%**	**13.4%**	**16.0%**	**33.3%**	**-2.3%**
Share price	**25.8%**	**4.1%**	**24.2%**	**40.3%**	**-2.3%**
TSE TOPIX Total Return Index	**29.3%**	**4.2%**	**24.3%**	**15.5%**	**-3.2%**

Past performance is not a reliable indicator of future returns.
Source: Morningstar as 30.04.2019 bid-bid, net income reinvested. The TSE TOPIX Total Return Index is the comparative index of the investment trust.

So if the growth prospects of the world's third-largest stock market sound appealing, listen to your instincts and discover more about Fidelity Japan Trust PLC.

The value of investments can go down as well as up and you may not get back the amount you invested. Overseas investments are subject to currency fluctuations. The shares in the investment trust are listed on the London Stock Exchange and their price is affected by supply and demand. The investment trust can gain additional exposure to the market, known as gearing, potentially increasing volatility. This trust invests more heavily than others in smaller companies, which can carry a higher risk because their share prices may be more volatile than those of larger companies.

To find out more, go to fidelity.co.uk/japan or speak to your adviser.

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Stock markets tumble as the trade war reheats

There is also the threat of faster interest rate hikes in the UK

The nascent recovery in global stocks in 2019 has suffered a significant setback. The culprit is renewed escalation in trade tensions between China and the US – an issue the markets were previously hoping would soon be resolved.

Those hopes have been dashed by an increasingly belligerent tone from the Trump administration, with an increase in tariffs on Chinese goods met by retaliation from Beijing.

Hints from Trump on 13 May of a deal in 'three or four weeks' helped stem some of the market panic. Yet earlier the same day the S&P 500 index of US companies endured its worst session since 3 January with more than 90% of its constituents in negative territory.

Since the issue exploded into life on 8 May, several stocks in the FTSE 350 have also taken a hit. Unsurprisingly the list is dominated by industrial stocks which would be disproportionately affected by a reduction in global trade.

Mining stocks also feature, given China's status as a major consumer of commodities, with obvious implications for demand if the country experiences a slowdown.

SOME OF THE VICTIMS OF THE TRADE WAR

Company	% return since close on 8 May
Renishaw	-10.2
KAZ Minerals	-7.0
Rotork	-6.8
Melrose Industries	-6.4
Bunzl	-6.3
Man Group	-5.6
Spectris	-5.4
Aston Martin Lagonda Global Holdings	-5.1
TI Fluid Systems	-5.0
Fidelity China Special Situations	-4.6
Antofagasta	-4.4

Source: Sharepad, 14 May

China-specific investment trust **Fidelity China Special Situations (FCSS)** has also come under pressure.

These are the areas of the market to watch as the tit-for-tat exchanges between Beijing and Washington continue.

To an extent the FTSE 100 has been insulated from some of the pain by weakness in sterling as the wait for clarity on the UK's exit from the European Union goes on.

Weaker sterling increases the relative value of the overseas earnings which dominate the index.

Something to monitor in the UK, beyond the long-running Brexit saga, is the jobs market and how that may result in higher interest rates.

The latest figures (14 May) showed a lower-than-expected unemployment rate and wage growth which continued to outpace inflation, even if it slipped back a little.

Thomas Pugh, UK economist at consultant Capital Economics, says: 'The implication of solid wage growth combined with low productivity growth is that firms' costs are rising. So far it appears that firms are absorbing higher labour costs by squeezing their margins, but this cannot go on indefinitely.

'Eventually firms will have to pass on rising costs to consumers in the form of higher prices,' he adds. 'This will push up inflation and force the Bank of England to raise rates to 1.5% by the end of 2021, compared to market expectations of just 1%.'

HOW GLOBAL MARKETS REACTED

Index	% return since close on 8 May
Nasdaq 100	-3.9%
Hang Seng (Hong Kong)	-3.0%
S&P 500	-2.4%
DAX Xetra (Germany)	-2.2%
Nikkei 225 (Japan)	-1.9%
FTSE 100	-0.8%

Source: Sharepad, 14 May

Vodafone cuts its dividend back to 2009 levels

This frees up money for future growth although investors will suffer lower income

FTSE 100 telecoms group **Vodafone (VOD)** has pulled a massive U-turn and slashed its dividend by more than 40%, despite having committed six months earlier to maintaining the payment at the same level as the previous financial year.

The shares are now trading on a prospective yield of 6.1% versus 10% before the announcement.

For the year to 31 March 2018, the €0.1507 per share dividend cost the mobile phone giant €4bn (£3.5bn). The full year dividend has now been cut to €0.09 per share, or approximately 7.8p, taking the income back to 2009 levels and ending a 20-year run of rising income payments to shareholders.

Vodafone's share price had been falling for a long time amid concerns about its ability to sustain dividends in light of investment requirements and high levels of debt. Having peaked at 238p in January 2018, the shares nearly halved to 131.78p on the eve of the dividend cut.

The shares fell nearly 4% on the dividend news to 126.84p despite a huge cloud now being lifted from the investment story.

The change in dividend policy will save the company about £7bn over the next five years, funds that will be needed if Vodafone is to successfully return to growth, while giving it more scope to repay its €27bn (£23.4bn) net debt.

Vodafone saw revenue and earnings before interest, tax, depreciation and amortisation (EBITDA) post single-digit declines in the financial year ending 31 March 2019. But excluding a sea of adjustments the company reported a €7.64bn pre-tax loss, although that does include hefty discontinued operations.

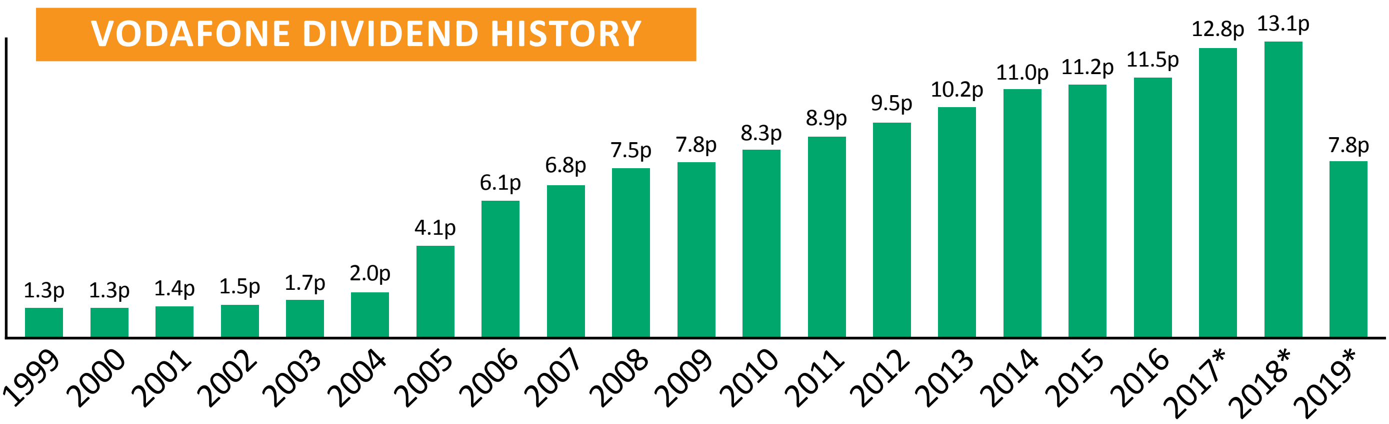
Future growth is focused on selling its converged fixed-line, broadband and mobile networks more widely to businesses and consumers across Europe, providing next generation internet of things and cloud services while using digital transformation initiatives to improve customer service.

It is also making a big bet on fifth generation (5G) mobile. Vodafone expects to launch the UK's first 5G services in seven UK cities on 3 July.

Vodafone's strategy on dividends is in stark contrast to fellow telecoms stock **BT (BT.A)** which has also been the subject of intense speculation regarding its own dividend.

Chief executive Philip Jansen, who only assumed the hot seat on 1 February this year, has confirmed plans to maintain BT's dividend at 15.4p per share for the year to 31 March 2019 while expressing confidence for a similar payout this year.

This implies an income yield of nearly 7.5%, but analysts believe BT's commitment to faster fibre roll-out and improving cash flow dynamics underpin dividend security.



Source: Vodafone, Shares. Rounded up to 1 decimal point. * 2016-2019 restated from €

Customer and investor panic wipes £2.8bn off Metro Bank's value

Don't buy its shares following recent price slump

Shares in **Metro Bank (MTRO)** made fresh all-time lows this week, hitting 462.75p after photos appeared of large numbers of customers queuing to withdraw their money amid social media chatter questioning the bank's financial health.

The bank told customers their money was safe and insisted a planned £350m capital raising was still on.

Anyone invested in the stock will have been through a rocky ride as the shares have lost 86% of their value since July 2018, wiping £2.8bn off the company's market value.

Metro's key troubles began in January this year when an accounting error meant that it had underestimated the risks for various loans for commercial and buy-to-let property. That triggered a need to boost its capital to cover the riskier products.

The shares tumbled from £22 to £13.45, the largest one-day fall in a British bank's share price since the financial crisis, and sparked earnings downgrades from several brokers.

Shortly afterwards it emerged that the error hadn't been picked up by the bank itself but by the Bank of England's Prudential Regulatory Authority which is charged with overseeing high-street lenders.

Cue another share price collapse to below £11 leaving shareholders nursing losses of more than 50% in seven trading days and sparking rumours of class action lawsuits.

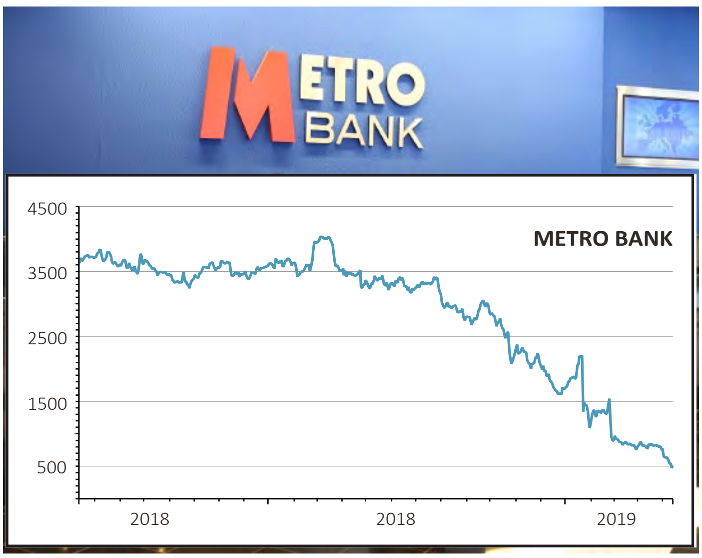
There was a brief moment of respite in late February when the bank was awarded £120m from the Banking Compensation Remedies scheme, but less than a week later the shares resumed their downward spiral after the bank abandoned its medium-term growth targets and revealed a plan to tap investors for £350m of new funding.

While some of Metro's problems are common to the whole sector – a highly competitive mortgage market, which is squeezing profit margins, and rising wholesale debt markets which make funding more expensive – much of the damage has been self-inflicted.

Earlier this month the shares took another beating as profit in the first quarter halved and 'a small number of large commercial and partnership customers' withdrew their deposits due to 'adverse sentiment'.

The bank has hinted that it might sell or securitise some of the assets which need a higher level of collateral to back them but scenes of customers queuing to withdraw their money conjure up unpleasant memories of the run on Northern Rock in 2007, albeit the latter was on a significantly greater scale.

There will be some investors who think that the shares have fallen far enough, but in our view even if the bank gets its capital raise away successfully the risk of permanent loss of capital outweighs the short-term upside potential. Avoid Metro Bank's shares.



Why are Centrica shares trading at more than 20 year lows?

We discuss what has led the company to this point and what it needs to win investors over

At 95.8p energy firm **Centrica (CNA)** is trading at its lowest levels since 1998 when then-chancellor Gordon Brown introduced a windfall tax on privatised utilities.

It has been a bumpy ride for Centrica over the entirety of the intervening period thanks to several operational challenges.

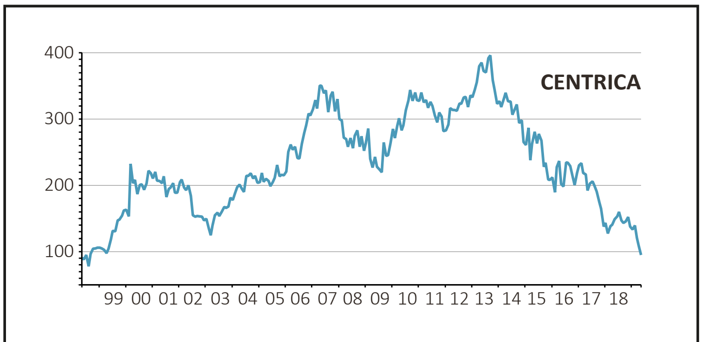
This indicates how, over the long run, share prices reflect the underlying fundamentals of a business. The question now is if Centrica can deliver on its targets, and crucially, maintain the dividend? If it can then the current negative sentiment could dissipate.

On 13 May the company maintained its full year guidance for operating cash flow and net debt, saying that its operational performance was largely in line with expectations for the first four months of 2019. The update gave some relief to the market.

However, Centrica did caution that it faces a number of headwinds, including the expected negative impact from the UK default tariff cap, warmer weather and falling natural gas prices.

The tariff cap came into force in January 2019, and will be in place until at least the end of 2020. It saw Centrica take a one-off £70m impact in the first quarter.

In light of the challenges, management continue to focus on factors within their control, such as improving the customer service proposition, reducing costs and maintaining financial discipline. The company reiterated its 2019 targets including adjusted operating cash flow in the £1.8bn to £2bn range.



Of the targeted £250m efficiency gains, only £58m were delivered to the end of April, which puts into question the full year target.

WHAT IS CENTRICA'S LONG-TERM TRACK RECORD?

Centrica was formed in 1997 following the demerger from British Gas plc, which was named BG Group. British Gas Sales and Gas Trading, the retail business, together with the gas production assets of the North and South Morecambe gas fields became part of Centrica, which maintains the British Gas retail brand.

At the beginning of May 1999, Centrica shares were trading at 110p, implying that shareholders have suffered a 13% loss over the ensuing 20 years. That would be misleading, since the company has paid out dividends every single year.

According to Refinitiv data Centrica has delivered a total return, factoring in dividends, over the last 20 years of 111.5% against 157.5% for the FTSE All-Share.

Since Centrica was formed from the demerger, revenue has increased from £6.4bn to roughly £28bn today. A growth rate of 7.7% a year, which looks a decent performance.

The problem has been converting those revenues into operating cash. Back in 1999, the company was generating £1.4bn and it expects between £1.8bn and £2bn in the current year. This represents a growth rate of just 1.5% a year.

Hacking scandals will drive more business to Avast

The FTSE 250 firm is well placed to profit as consumers and business seek digital protection

Earlier this week Facebook's messaging app WhatsApp became the latest big name brand to admit to falling foul of hackers, who apparently remotely installed spyware on some users' phones.

This would seem to be a near perfect environment for technology security providers like **Avast (AVST)**, where we believe there is a share price re-rating story to come.

Czech Republic-based Avast is one of the world's biggest cyber security providers to consumers, with more than 435m people worldwide using its Avast and AVG firewall, anti-hacking, malware and anti-virus toolkits.

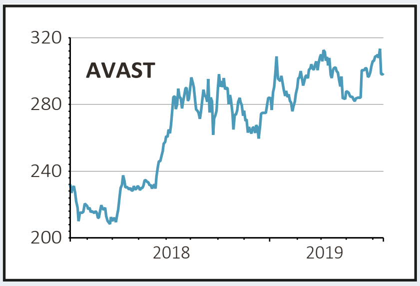
You may well have been sold one of its security packages the last time you bought a desktop PC or laptop. About 70% of 2018's $811.5m adjusted revenue came from desktop users. But there is enormous scope to tap into the global mobile device market, namely smartphones and tablets.

The company mainly sells direct to consumers and it also supplies various endpoint protection, device performance and privacy tools, password management and parental control solutions to small businesses.

Most of its consumer users at present take the free version of basic tools, with just 4% upgrading to a bells and whistles paid-for version, although penetration rates vary across countries and regions. That implies there is 'significant cross-sell and upsell potential', according to analysts at Jefferies.

AVAST BUY
(AVST) 298.8p
Stop loss: 239p

Market cap: £2.84bn



This so-called 'freemium' model, where basic services are given away for free in anticipation that users will upgrade down the line, is a proven and powerful marketing tool.

The key is to convince an increasing number of users to pay up. This is gradually happening on the desktop side, albeit fairly slowly. Last year saw a 7.2% increase in paying users and Avast is selling more products per user, up from 1.32 on average to 1.4.

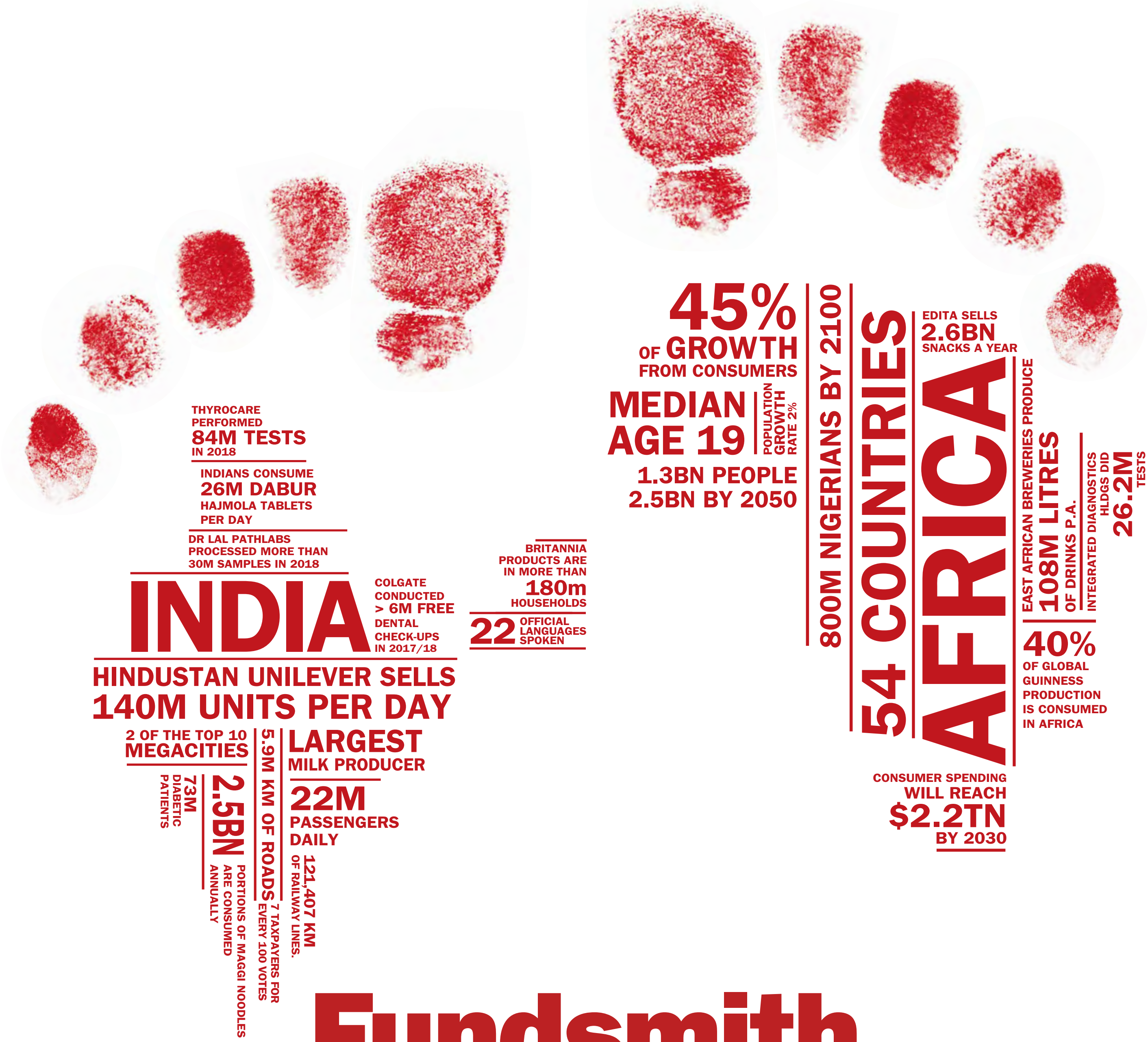
That fed through to an 8.6% rise in average revenue per customer which now stands at $49.24. Underlying operating profit margins were 51%.

It recently launched Avast Omni which provides protection to connected devices in the home and on the go, as well as an updated version of its secure internet browser.

Net debt of $1.14bn at year end should now be nearer to $0.9bn after a $200m repayment in March, and this is comfortably supported by strong free cash flow which stood at $394m last year. This also supports the payment of dividends, forecast to be $0.12 per share this year, implying a 3.1% yield.

The shares trade on 13 times UBS's 2019 earnings forecast which is a rough 40% discount to **Sophos (SOPH)**, the other FTSE 250 cyber security provider.

By **Steven Frazer**
News Editor



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a guide to future performance.

% Total Return

	2018	2017	2016	2015	2014	Since inception to 31.12.18
FEET Net Asset Value	–3.0	+21.2	+12.0	–7.0	+0.1	+22.7
MSCI Emerging & Frontier Index (£ net)	–9.3	+25.3	+32.4	–10.0	+0.5	+36.1

Source: Financial Express Analytics, MSCI.com, Inception 25.6.14.

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Why you should buy this trust managed by an activist billionaire

Gain exposure to the highest quality businesses Pershing Square has owned

A 26.7% discount to net asset value (NAV) at **Pershing Square (PSH)**, is a buying opportunity. The discount is wide because some investors lost faith following a poor performance since a high-profile 2014 launch on Euronext Amsterdam and subsequent 2017 London listing.

However, *Shares* likes the look of the quality underlying portfolio and believes a continuation of the more recent performance uptick offers a powerful catalyst.

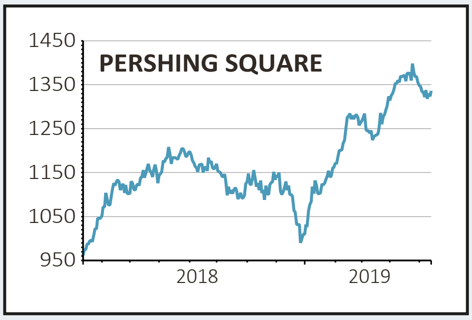
Pershing Square is an investment trust that makes concentrated investments in North American-domiciled large cap companies.

This is an actively managed portfolio of high-quality companies with higher earnings growth than the S&P 500.

The portfolio is managed by Wall Street billionaire Bill Ackman's Pershing Square Capital Management. Activist investor Ackman puts money to work in companies that generate relatively predictable, growing free cash flows with 'formidable barriers to entry and a compelling value proposition'.

Think excellent businesses which are protected by large competitive moats and boast opportunities for improvement; common traits are high returns on capital, long-term growth trajectories, and unique and irreplaceable brands or other assets.

PERSHING SQUARE
BUY
(PSH) £13.36
Stop loss: £10.69



As an activist, Pershing often works directly with management to unlock value.

In early 2018, Pershing Square took steps to address a sub-par performance, actions which had a positive impact on NAV performance during 2018. NAV has also performed strongly into 2019 thanks to strong portfolio earnings growth.

Initiatives taken to narrow the discount include a May 2018 tender offer and share purchases by Ackman and other members of the Pershing Square management team, while the fund has also introduced a quarterly dividend in a bid to entice income seekers. It yields 2.3%.

As at 30 April 2019, there were 10 long positions and no shorts in the portfolio. The absence of shorts means there is merit in Ackman's belief Pershing Square is best thought of as an investment holding company rather than a hedge fund.

Today, he insists 'we own one of the highest quality collections of businesses we have owned since the inception of Pershing Square'.

The portfolio includes the likes of Restaurant Brands, generating high-margin royalties from the *Burger King*, *Tim Hortons* and *Popeyes* brands, coffee chain mega-cap Starbucks and tacos-to-burritos restaurant chain Chipotle Mexican Grill.

Other positions include property developer Howard Hughes, home improvement chain Lowe's, Fannie Mae and Freddie Mac and global hotels and resorts giant Hilton Worldwide.

By **James Crux**
Funds and Investment Trusts Editor

A CONTRARIAN APPROACH CAN PAY DIVIDENDS

As contrarian investors, we prefer to plot our own course rather than follow the herd. Our quest is to find 'ugly ducklings' – companies that are shunned by others but offer a real prospect of improvement. And while the obvious upside to this approach is the potential for share price appreciation, it can also offer another valuable source of returns as unfashionable companies often have higher than average dividend yields.

Seeing the value in ugly ducklings

It goes without saying that the 'ugly ducklings' we choose are unloved, but we believe that they have the potential to improve their businesses. We look for companies that have the strength and flexibility to adapt and thrive over the longer term. A sustainable dividend from such companies is attractive to us as it offers a return while we wait for our thesis to unfold.

Of course, not every investment in our portfolio pays dividends and we wouldn't necessarily overlook a prospective investment for that reason. A company navigating the low point in its cycle might opt to forgo a dividend to reinvigorate its business. This prudent approach can hasten the company's recovery and potentially allow more sustainable dividend payments to recommence. Indeed, a dividend reinstatement can be an important signal that the company's rehabilitation is underway.

This scenario is currently playing out at Tesco, one of our biggest holdings. Tesco cut its dividend after a difficult period, during which profits fell and discounting rivals gained market share. Since then, the company has regained its footing, allowing management to reintroduce the dividend.

As long-term investors, we have time on our side as we wait for a nascent recovery to become established. Patience is key to contrarian investing. A certain fortitude is also required to withstand the anxiety of the market, while holding steadfastly to our convictions. But the potential pay-off can be more than worth the wait.

From sour grapes to an exceptional vintage

One of the most notable successes of this patient approach is Treasury Wine Estates, formerly the biggest holding in our portfolio. We invested in this company in August 2015, when it was very much out of favour. The catalyst for change was a new management team, whose strategy transformed the business from an 'ugly duckling' to an elegant swan, before we decided to sell our stake (or, to continue with the metaphor, it flew our nest) leaving a £39 million profit – almost three times our original investment. While not all of our investments will prove fruitful, this example demonstrates why patience can be such a virtue.

> “a return while we wait for our thesis to unfold”

Enduring growth

Paying dividends to our own shareholders has been part of our heritage of 132 years. We've recently increased the frequency of our dividend payment to quarterly. One of our aims is to grow the dividend ahead of UK inflation and this is supported by a record of raising our dividend in each of the last 35 years. However, it should be remembered that dividends are not guaranteed and can fall as well as rise. ■

14 May 2019

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THE SCOTTISH
Investment Trust

High conviction, global contrarian investors

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The Scottish Investment Trust PLC

RENISHAW
(RSW) £39.32

FANTASTIC STOCKS FOR 2019

Gain to date: 3.4%

Original entry point:
Buy at £38.04, 20 December 2018

JUST AS PRECISION measurement kit maker **Renishaw (RSW)** was beginning to regain some momentum following its profit warning in March, it promptly warned again (14 May).

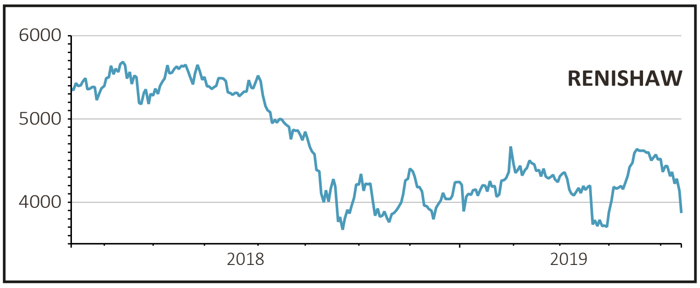
The market appears to have largely taken the news in its stride, with the stock falling 15% at the open on the news but recovering quickly to trade only 6% lower by the middle of the trading day.

Slowing demand from consumer electronics markets in Asia look to be the culprit again and the current trade tensions between the US and China are unlikely to be helping in this area.

The company downgraded its guidance for the 12 months to 30 June after its profit for the first nine months of its financial year fell 19%. Pre-tax profit for the nine months through to March dropped to £84.8m, down from £104.4m a year earlier.

Revenue inched up 0.3% to £431.1m; Renishaw says it now expects full-year revenue to be in the range of £580m to £600m, down from previous guidance of £635m to £665m.

Pre-tax profit is now seen in the range of £111m to £126m, down from previous guidance of £146m to £166m.



SHARES SAYS:
Renishaw is a quality company and notwithstanding these recent mis-steps, we remain positive. We will however be watching the guidance which accompanies full year numbers closely. Sit tight.

ON THE BEACH
(OTB) 438p

FANTASTIC STOCKS FOR 2019

Gain to date: 21%

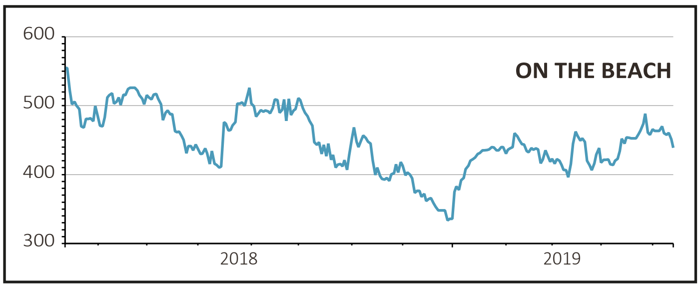
Original entry point:
Buy at 362p, 20 December 2018

IN A BATTERED market where bookings have shrunk 10% in 2019, online beach holiday retailer **On The Beach (OTB)** has stormed ahead of its competition with a 12% rise in pre-tax profit to £11.9m and a 41% jump in revenue to £63.5m in the six months to 31 March.

And with Brexit still uncertain – putting off some holidaymakers from booking – the company has sounded a more cautious note for the remainder of the year.

Chief executive Simon Cooper says: 'Whatever upset we face in the market, it affects our competitors too, and it will affect them more than us. Unlike tour operators we don't have any fixed inventories we need to sell at a discount to protect sales,' he says.

While the outlook remains cloudy until Brexit is resolved, Cooper adds that group will start to feel the benefit later this year from its acquisition of operator Classic Collection as it looks to break into the offline market, which is worth around £7bn a year, according to investment bank Liberum.



SHARES SAYS:
On the Beach is holding up well in a tough market and its acquisitions could supercharge growth. Keep buying.

INCOME ALERT

WILL CAR INSURERS PUT THE BRAKES ON BIG DIVIDENDS?

Motor and home insurance stocks have generated significant returns for investors over the past decade with the FTSE All-Share non-life insurance index almost trebling between 2009 and the middle of 2018.

However increased competition, rising claims – and the need to hold more capital to meet future claims – together with tighter regulation mean that the party may be coming to an end.

While the sector pays attractive dividends, are these high yields enough to compensate for the increased risk? We believe there is a significant threat to future dividend payments which means investors may have to think twice about holding these stocks.

SIZE ISN'T EVERYTHING

The UK is the world's fourth largest insurance market after the US, China and Japan. In 2017 total premium income was £220bn, of which roughly 40% or £90bn was non-life business according to the Association of British Insurers (ABI).

While this is a sizeable market, premiums have actually shrunk slightly since 2015 due to rising price competition spurred by regulatory changes, including sweeping reforms to the personal injury compensation system, and consolidation among the various players.

There are further changes coming with the way in which the size of large personal injury claims is calculated (known as the Ogden rate) due to take effect this year and the Civil Liability Act (2018) coming into effect next year. These are likely to reduce profits and increase the amount of capital the insurers need to keep to meet future claims.

BATTEN DOWN THE HATCHES

After a series of extreme weather events in 2013 and 2015, the UK had a fairly benign time weatherwise in 2016 and 2017 in contrast with much of the rest of the world.

That all changed last year when the Beast from the East caused £328m of weather-related claims in March, causing some insurers to use up their full year's weather reserves in the first quarter.

This was followed by record-breaking summer temperatures and minimal rainfall which caused a surge in subsidence claims with both the volume and value of the claims at the highest level for several years.

A recent paper from the Environment Agency predicts that climate change will mean more extreme weather and flooding for the UK and that costs for the banking and insurance industries could rise dramatically with losses on mortgages potentially trebling.

A previous report from the Committee on Climate Change estimates that in 50 years up to 1.5m properties in England could be in areas of 'significant' flood risk.

While the insurers might be able to charge higher prices to offset some of the increased risk, more frequent flooding and extreme weather events mean they will need greater reserves of capital than in the past to meet higher claims.

MOTOR INSURERS GETTING BOXED IN

The motor insurance market has become markedly more competitive in the last 12 months with premiums falling around 5% during the course of 2018 as providers fight to retain customers.

Profitability is an ongoing challenge as the industry struggles with flat or falling revenues and a sharp increase in costs.

The common theme among the insurers in their 2018 results and 2019 trading updates is the record level of claims inflation, in particular bodily injury and third-party property (which in this case means vehicles).

ABI average motor premium index

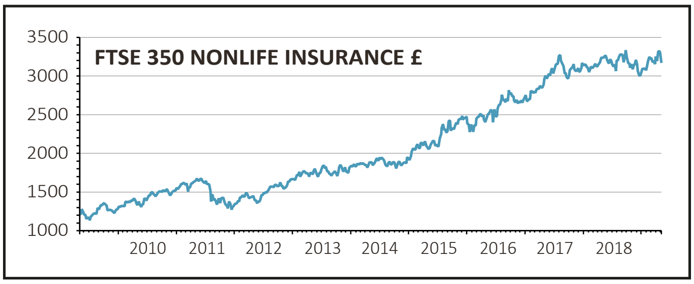
Source: ABI

UK motor underwriting profit and loss as a % of underwriting premiums 1984 to 2017

Source: ABI

Hastings (HSTG) recently cited high repair costs and third-party property damage costs as key issues and warned that 'if the current premium and claims dynamics continue through the year' the group's loss ratio would be at the top (i.e. worse) end of its target range. The term 'loss ratio' is used to describe the amount of claims paid to customers in relation to the total premiums received in a year.

In a similar vein, **Direct Line (DLG)** reported that premiums across the market were failing to keep up with claims inflation, which it said was running at the upper end of its long-term expectations of 3% to 5%.



The increasingly sophisticated technology used in cars has reduced the volume of claims but pushed up the cost of repairing and replacing damaged parts.

Rising labour costs and rising parts costs, exacerbated by the weak pound, mean that insurers are now paying £12m a day on repair costs alone, on top of £9m a day for bodily injury claims, according to ABI estimates.

Technology has also increased the insurers' losses on car thefts as thieves are targeting premium cars with keyless fobs by intercepting the signal between the key and the car.

The average claim for a stolen car was over £8,000 in the second quarter of last year against £3,500 five years earlier and police records show the trend of thefts increasing.

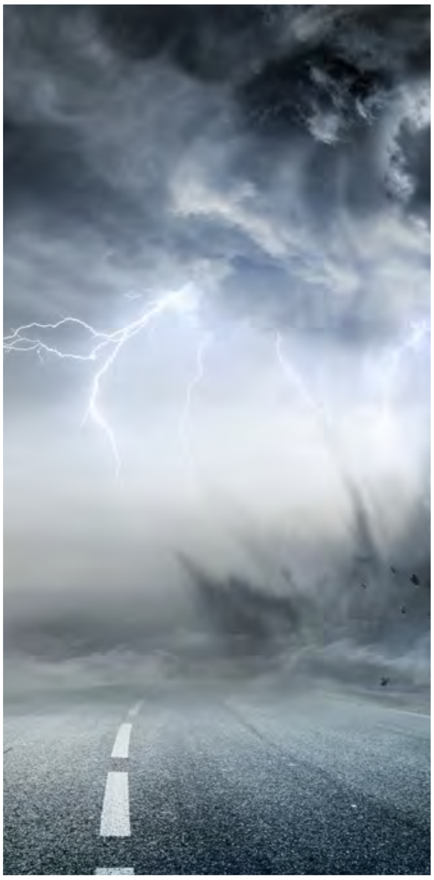
Home insurance: there may be trouble ahead

The Environment Agency has launched a consultation paper on its flood policy with the warning that climate change will lead to more extreme weather events in the UK, impacting the banking and insurance sectors.

The agency predicts that the number of houses built on floodplains will double over the next 50 years and that building flood and coastal defences will cost an average of £1bn per year.

Chairwoman Emma Howard Boyd advises that, despite improving coastal defences and contingency plans, it won't be possible to protect everyone. She says: 'In some places we can't eliminate all flooding and coastal change and we need to be better at adapting to the consequences.'

Some communities which have suffered severe flooding in the past will have to decide whether to stay and risk more frequent and more damaging floods or move out of harm's way and abandon their homes altogether.



In 2013 a tidal surge hit the east coast and the Humber estuary forcing thousands of people to abandon their homes as areas of the North Sea rose more than five metres, exceeding the levels of the infamous 1953 surge which flooded 1,000 square kilometres of land and killed over 300 people.

The 2013 floods, combined with what until then was the wettest winter on record, cost the UK insurance industry £1.2bn or an average of £31,000 per claim.

In 2015, heavy flooding cost the industry a further £1.3bn or an average payout of £50,000 per claim according to the ABI.

REGULATORS ARE ABOUT TO HEAP ON MORE PRESSURE

Faced with fierce competition for customers and a high levels of costs, the last thing the insurers need is public pressure to cut premiums.

However the Financial Conduct Authority (FCA) and the Competition and Markets Authority (CMA) have both announced investigations into unfair pricing in the non-life insurance market (also known as the general insurance market).

Last autumn the FCA launched a probe into what it called the 'excessive difference between premiums charged to new customers and those renewing', with the former getting better prices at the expense of the latter, especially in home insurance.

It promised to ensure that the general insurance market delivers 'competitive and fair prices for all consumers' and 'if change is needed to make the market work well we will consider all possible remedies' including intervening directly.

This could mean fines for misconduct, or worse, making the insurers compensate customers for past mistreatment.

Carphone Warehouse was fined for mis-selling insurance

There is also a risk that these 'remedies' spill over into the motor insurance business which for most quoted companies is much bigger than home insurance in terms of premium income.

For the avoidance of doubt, the FCA sent a 'Dear CEO' letter to the heads of all the general insurance firms citing the example of Carphone Warehouse which it fined £29m for mis-selling insurance.

ARE DIVIDENDS AT RISK?

Historically the general insurers have been popular with income investors as they tended to pay a dividend yield well above the market average.

INSURANCE DIVIDEND YIELDS

	2018A	2019E	2020E
ADMIRAL (£20.38)			
Dividend per share (p)	126	136.9	130.5
Dividend yield	6.2%	6.7%	6.4%
DIRECT LINE (312p)			
Dividend per share (p)	29.3	28.7	28.2
Dividend yield	9.4%	9.2%	9.0%
HASTINGS (182p)			
Dividend per share (p)	13.5	13.7	15.3
Dividend yield	7.4%	7.5%	8.4%
SABRE (267p)			
Dividend per share (p)	20	20	19.2
Dividend yield	7.5%	7.5%	7.2%

Source: Refinitiv

Today Direct Line is trading on a prospective yield of 9.2% and Hastings is on a yield of 7.5% so the income argument is still valid assuming that the dividends aren't cut.

For 2019 and 2020, the consensus sees **Admiral (ADM)**, Direct Line and specialist insurer **Sabre (SBRE)** paying almost all of their earnings out in dividends while Hastings is seen paying out around 70% of earnings.

Direct Line is the second-biggest player in motor insurance among the non-life players after Admiral, with just under £1.7bn of gross premiums last year, and the biggest home insurer with over £600m of gross premiums although it is worth flagging that these were down sharply last year. It is also the most profitable in both lines.

For Admiral and Hastings, home insurance is barely profitable. Admiral made a big push in home insurance last year increasing the number of properties it insured by 31% to 870,000 and increasing its gross premiums from £107m to £146m, yet it turned from a profit of £4.1m to a loss of £3m.

For Hastings, home premiums last year were £7m against motor premiums of £950m so it is hardly a meaningful part of the business, and Sabre only offers motor cover.

Given how exposed Direct Line is to the UK home and motor markets and how much margins are under pressure in the motor business, we would be concerned about the safety of its dividend, which includes an assumed 7p special payment on top of normal dividends.

Admiral has a large overseas motor insurance business which generated £484m of gross premiums last year and it owns a price comparison business, including the Confused.com brand, which generated over £150m of premiums.

This makes its revenue base more diversified although both units are loss-making which weighs on earnings and may put the prospective 6.7% dividend yield at risk.

Hastings is almost a pure play on motor insurance so it will feel the squeeze from softening premiums and rising claims inflation the keenest, but it also has the most leeway to maintain its dividend which at 7.5% is still well above the market average.

All these factors suggest that anyone relying on generous dividends from insurance stocks must ensure they have alternative sources of income via a diversified portfolio in case insurance sector dividends don't grow or are cut in the short to medium term.

By **Ian Conway** Senior Reporter

Is intellectual capital the next big investment theme?

DWS believes this is a good way to spot firms with strong earnings growth

When you think of thematic investing, words like risky, narrow and short-term fad could easily come to mind.

After all, several coal mining, nuclear and even shipbuilding investment funds launched when commodities were all the rage 10 years ago, the majority of which no longer exist today.

Popular themes at the moment include robotics, artificial intelligence and renewable energy, and while these areas would appear long-term, sustainable trends, the same thing was said about the aforementioned commodity, energy and transport products a decade ago.

Taking a thematic approach to investing can be a sensible path to follow but isn't a guaranteed road to riches. It requires you to take a view about how long a trend will stay positive and

whether following this trend will give you an edge over the market.

With is in mind, we're intrigued by another emerging theme which is innovative in nature. The premise of this theme is investing in companies which can make good money from intellectual capital – i.e. brand names and their own research and development (R&D).

This includes both the innovative tech firms pumping loads into R&D, and also others that simply have a really strong brand name – the likes of Coca-Cola, Nestlé and L'Oreal for example.

WHAT IS INTELLECTUAL CAPITAL?

It is made up of intangible assets including research and development, and brands.

Company accounts tend to not treat intellectual capital as an asset. An asset is the result of capital expenditure but intangibles are treated as an operating expense.

LEARNING FROM THE TREND

DWS recently launched investment fund **DWS Invest CROCI Intellectual Capital** to give investors access to a selection of these names.

While the fund is not currently available for retail investors, the premise behind the product does give investors useful insight into the power of intellectual capital and how you may want to incorporate the same thinking when looking for stocks to buy.

DWS views intellectual capital as a better way to access earnings growth because firms with relatively little physical capital (such as factories) and a larger amount of intangible assets are driving structural change in the global economy.

Its research shows that companies which have intellectual capital are already earning more than companies which don't have intellectual capital and will continue to do so in the future, and it argues that such intangible assets have become the strongest engine of growth in modern economies.

FOCUS ON R&D

It attempts to measure intellectual capital by viewing R&D expenses and advertising expenses, i.e. developing the brand, as capital expenditure, putting the cost of each one onto the balance sheet in its research of a company.

Often these firms are the same large caps that virtually everyone knows, like Apple and Facebook, but it does exclude other giants that could be in for a tough time, such as some of those in the materials and energy sectors.

Francesco Curto, head of active and passive research at DWS, says this part of the market is 'eating the breakfast, lunch and dinner' of the other part of the market.

Data from DWS covering 787 large companies between 2007 and 2018 shows a 0.6% decline in annualised earnings for those without intellectual capital, compared to 3% growth for companies which invest in R&D and 3.4% for those with a strong brands.

Curto says: 'If you buy equities with the long-term in mind, you cannot ignore there is a structural change happening in the economy.'

DWS forecasts that by the end of 2019 firms with intellectual capital will have grown their earnings in real terms by more than two thirds in the past decade. In comparison, it believes those without intellectual capital may see earnings fall by more than a quarter compared to their peak in 2007.

POPULAR SECTORS FOR INTELLECTUAL CAPITAL

- **Healthcare**
- **Information Technology**
- **Communication Services**
- **Consumer Discretionary**

Curto adds that 40% of the broader global benchmark today has seen a decline in earnings growth, and is at risk going forward due to their lack of investment in intellectual capital.

UNDERSTANDING INTELLECTUAL CAPITAL

Breaking down how to look at companies with intellectual capital, Jessica Singleton, an investment specialist for index investing at DWS' Xtrackers arm, uses Google owner Alphabet as an example.

'Google properties account for nearly all of Alphabet's revenues, but what the figures fail to mention for example is that Alphabet is a pioneer in driverless cars. When you think about Alphabet, you think about Google, etc, but that misses a huge part of what they're trying to do,' she says.

Alphabet's self-driving car start-up Waymo accounted for only $154m of its $39.27bn revenues in the last three months of 2018.

While it may not seem much now, a recent note from investment bank UBS estimates that by 2030 Waymo could be raking in $114bn in annual revenue, highlighting its huge potential in the long-term.

Investing in companies with intellectual capital seems to make a lot of sense, so why haven't more people looked at this before?

'When you think about R&D and brands, it's not a normal source of capital,' says Curto. 'On the balance sheet it doesn't exist. R&D is written off in the profit and loss statement because (accountants) don't know how to measure it precisely.'

As a final point, spotting a company that spends money on R&D isn't enough when looking for suitable investments. DWS says innovation must ultimately generate profits and value for investors.

By Yoosof Farah
Reporter

ESTIMATED ECONOMIC LIFE OF INTANGIBLE ASSETS

- **Pharmaceuticals (R&D) 10 to 15 years**
- **Chemicals (R&D) 4 to 7 years**
- **Automotive (R&D) 5 to 7 years**
- **Engineering (R&D) 4 to 7 years**
- **Technology (R&D) 2 to 4 years**
- **Consumer Goods (Brands) 4 to 15 years**

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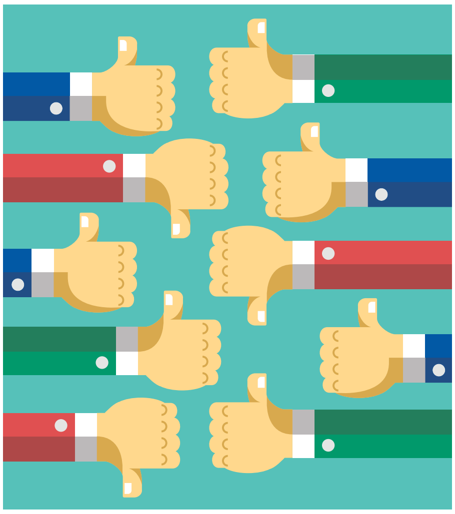
How to spot the best multi-asset funds

We reveal the best and worst performers over the past 10 years

Multi-asset funds are growing in popularity as investors seek a one-stop shop for their money. They have the freedom to invest wherever they see fit in order to meet their objectives: across equities, bonds, property, gold and many other assets.

Such a broad remit in a fund is understandably attractive to investors at a time when markets have been difficult to predict. But the multi-asset fund space is not an easy one to navigate – there are a whopping 153 funds to choose from in the Mixed Investment 20-60% Shares sector alone and 96 have a 10-year record.

What's more, this is just one of three sectors into which multi-asset offerings can fit, and the remits and performance of each can vary greatly, showing how hard it can be for investors to find the best choice for their needs.



HOW DO THEY WORK?

The criteria for a fund to be part of the Mixed Investment 20-60% Shares sector, as the name might suggest, is that the portfolio should have between 20% and 60% of its assets invested in equities. That wide range means the group contains funds whose objectives and investment strategy vary greatly.

While it is certainly positive that investors have so much choice, this can make it difficult to compare the funds fairly. Those with significantly higher returns may be taking a lot more risk to achieve their outperformance and the funds at the bottom of the pack may not look as appealing but may be meeting their remit by producing smaller but steady returns.

HOW DO YOU PICK A FUND?

When choosing a multi-asset fund, it is vital that you look at the aim of the fund and how it sets about achieving its goals, including how much risk the manager will take.

One of the best ways to whittle down such a great number of funds is to look at their track records over an entire stock market cycle.

Analysis by AJ Bell shows the performance of funds in the Mixed Investment 20-60% Shares sector which have been around at least 10 years.

Simon Molica, fund manager at AJ Bell, says: 'For a good multi-asset strategy I would expect to see an experienced fund manager or team running the mandate. These mandates have such a large opportunity set that it is also good to see when a team has access to specialist knowledge within their firm.'

He adds: 'We want to see a well-defined and articulated process and evidence that the manager has a good eye on risk monitoring so that there are

WHAT'S YOUR RISK APPETITE?

AJ Bell offers a range of passive multi-asset funds which act as ready-made portfolios and match different levels of risk appetite. For example, **VT AJ Bell Passive Moderately Adventurous (BYW8VL7)** has a c75% weighting towards equities, 18% of assets in bonds, 4% in cash and 3% in property.

no unintended risks influencing returns in the fund.'

WHICH FUNDS HAVE DONE WELL?

The top performer of the group is **Premier Liberation V (B675ST4)**, which has returned 175.8% over the past decade and produced an annualised return of 10.7% over that period. At the other end of the spectrum is **Miton Cautious Multi Asset (B0W1V85)**, which has returned 56.6% and produced an annualised return of 4.6%.

Premier Liberation V is a fund-of-funds, meaning that the manager selects other funds to invest in rather than investing directly into equities and bonds. It is part of a range of four funds which are managed to volatility targets and is the second least volatile of that range.

Some 27% of the fund's assets are in UK equities, through funds including **Evenlode Income (BD0B7D5)** and **JOHCM UK Opportunities (B95J5C1)**. It also invests in Japanese, US, Asian and emerging market equities as well as a number of bond funds including **Royal London Short Duration Credit (BJ4KW80)**, **Baillie Gifford Strategic Bond (0594774)** and **iShares UK Gilts All Stocks Index (B89VCR0)**, a UK Government bond tracker fund.

Highlighting just how different funds within this sector are to each other, the Miton Cautious Multi Asset fund is not a fund-of-funds as the manager instead chooses their own investments.

With a cautious approach, it is unsurprising that the top 10 holdings within the portfolio include US government bonds and gold bullion – some 31% of its £507m of assets are in bonds and 7% in cash. It also invests in big US stocks such as Microsoft and Paypal.

TOP 10 BEST PERFORMERS IN MIXED 20-60% SHARES SECTOR	Fund-of-funds?	Total return: annualised over 10 years (%)	Total return over 10 years (%)
Premier Liberation No. V Class C Acc	Yes	10.7	175.8
Premier Multi-Asset Distribution C Inc	Yes	10.4	170.2
Premier Multi-Asset Monthly Inc C Inc	Yes	10.2	164.6
Aviva Investors Distribution 2 GBP Inc	No	10.0	159.3
MI Hawksmoor Vanbrugh C Acc	Yes	9.7	152.4
Invesco Distribution UK Z Acc	No	9.6	150.8
Invesco European High Inc UK Z Acc	No	9.6	150.5
BMO MM Navigator Distribution C Inc	Yes	9.5	147.5
EF New Horizon Balanced Inc & Gr B Inc	Yes	9.5	147.1
SLI Dynamic Distribution Plat 1 Acc	Yes	9.3	144.0

Source: Morningstar. Data to 31 March 2019

HAT-TRICK FOR PREMIER

Premier Multi-Asset Distribution (B40RNW1) and **Premier Multi-Asset Monthly Income (B7GGPC7)** are the second and third best performing funds in the group over the past decade, making it a hat-trick for asset management group Premier. These funds, which have a focus on producing a reliable income, have returned 170.2% and 164.6% respectively over 10 years.

The lowest returns among the group are dominated by funds with a cautious focus. **MGTS Future Money Real Value Fund (B89JN48)**, for example, has the objective of beating inflation to maintain the real value of assets.

Around 11% of its portfolio is in cash and money market investments and more than 50% in bonds and fixed income investments. It has produced an annualised return of 5.5% and a cumulative return of 71.7% over 10 years.

TOP 10 WORST PERFORMERS IN MIXED 20-60% SHARES SECTOR	Fund-of-funds?	Total return: annualised over 10 years	Total return over 10 years (%)
L&G Multi Manager Income I Acc	Yes	6.5	87.5
Marlborough Cautious P Inc	Yes	6.2	83.1
VT Greystone Cautious Managed R Acc	Yes	6.1	79.9
LF Ruffer Total Return C Acc	No	5.9	77.0
WAY MA Cautious Portfolio E Acc	Yes	5.9	76.9
RBS INV Cautious Growth	No	5.8	76.2
Quilter Investors Divers R (GBP) Acc	Yes	5.8	75.8
MGTS Future Money Real Value R Acc	Yes	5.6	71.7
Aberdeen MM Diversity D Acc	Yes	5.2	66.6
LF Miton Cautious Multi Asset B Acc	No	4.6	56.6

Source: Morningstar. Data to 31 March 2019

By **Holly Black**

Witan is ready to fight back after lagging the market

The investment trust has growing competition from low-cost global tracker funds

Growing awareness among the general public of low-cost exchange-traded funds (ETF) means actively-managed funds have to try even harder to stand out from the crowd and justify their typically higher fees.

With ETF products such as **Lyxor Core MSCI World (LCWL)** offering exposure to companies around the world for a mere 0.12% annual charge, an actively-managed fund will need to be a compelling alternative in order to attract investors' money.

Among the active funds in this situation is **Witan (WTAN)**. Focused on global equities, its 0.75% ongoing charge (excluding performance fees) is very competitive versus the peer group yet still materially higher than the aforementioned Lyxor ETF.

Investment director James Hart acknowledges the competition from passive investment products such as ETFs and says Witan isn't complacent about its position in the market, despite having £2.1bn of gross assets and being one of the most popular investment trusts among retail investors.

Watch our recent video with Witan's Andrew Bell

'Anyone can buy a cheap index fund. We need to offer something superior because we charge more,' admits Hart.

PERFORMANCE HAS LAGGED

While Witan generally has a good performance track record, last year wasn't a trophy period for the investment trust. Not only did its net asset value fall by 8.4% on a total return basis, but it performed worse than the 6.5% decline from its benchmark – which is a mixture of indices tracking different geographic territories.

When assessing funds it is important to consider their style(s) and how that fits into current market conditions. In Witan's case, the value side of its portfolio suffered in 2018 as value remained out of favour as an investment style.

Performance is still lagging with the trust's net asset value up 8.5% in the first quarter of 2019 versus a 9% gain from its benchmark.

MUCH BETTER LONGER-TERM RECORD

While frustrating for the Witan team and shareholders, this is hardly disaster territory. Last year was a difficult market for most investors and the scale of the underperformance this year isn't that bad.

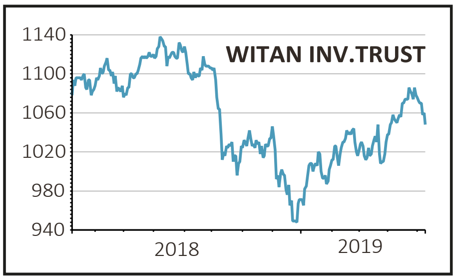
Ultimately a product like Witan should be judged on a much longer term and it is here that the investment trust has excelled.

Net asset value growth over the past five years was 64.9% versus 57.7% from the benchmark, and 268.2% versus 220% respectively over a 10-year period.

HOW DOES IT ATTEMPT TO BEAT THE MARKET?

Witan's strategy to deliver better returns than the market is to use a panel of third party managers, as well as running a small component itself, who are deemed to be experts in certain areas.

'We choose people to back for multiple economic cycles,' says chief executive Andrew Bell. 'We provide access to fund managers



you might not be able to access normally as a retail investor, plus a better deal with fees.'

All of the third party managers, bar one, are on one month's notice which gives Witan some flexibility. 'Some new funds, particularly those in the alternative energy space, are signing up managers for five years which can be a poison pill, in our view,' says Bell.

He explains that Witan has made changes to managers over the years for such reasons as streamlining the number of experts in certain areas but he aims to retain appointed managers for the longer term, rather than switch managers to suit which investment style is in fashion.

Some of Witan's managers should be well known to retail investors including Nick Train from Lindsell Train and Derek Stuart from Artemis. Others are under the radar such as Bevis Comer from Heronbridge Investment Management.

WILLING TO TRY NEW NAMES

Potential additions or replacements to the panel are constantly considered with up to 2.5% of the trust's assets acting as a nursery for new managers to prove their worth.

In April 2018, £14m (0.7% of net assets) was allocated to Latitude Investment Management to invest in global equities. This proved to be a good decision as its component of the Witan portfolio outperformed significantly, with a total return of 6.3% compared with the 1.0% return from its global index benchmark during the latter nine months of the year.

'The managers meet the board once a year and James (Hart) and I might meet them three or four times a year. However, we are quite hands-off. After all, these people are meant to be managing a portfolio, not talking about it all the time,' says Bell.

WHO WOULD WITAN SUIT?

While the yield may be fairly low at circa 2.3%, dividend growth has been an important factor with the investment trust. Dividends per share have more than doubled since 2008, rising 130% compared with 25% for the UK CPI rate of inflation and 65% dividend growth for the UK market.

A share split is planned for 28 May where shareholders will get five new shares for every one they already hold. It wants to make Witan's shares more appealing to individuals who like to make regular savings or reinvest their dividends. The current £10.60 price is deemed too high for many people to do this.

We **highlighted** Witan last month as one of the investment trusts to put in your ISA for the new tax year and we still rate it highly. We also believe it is suitable for anyone looking to add a solid global fund to their pension or even for a child in a Junior ISA.

It is a particularly good investment for someone who wants to 'buy and forget', namely put regular money into the fund and simply get on with their lives while Witan and its manager panel do all the hard work.

INVESTMENT MANAGER	MANDATE	STYLE
Artemis	UK	Recovery/Special situations
Heronbridge	UK	Long term value
Lindsell Train	UK	Intrinsic value
Lansdowne	Global	Mispriced mega-caps
Pzena	Global	Fundamental value
Veritas	Global	Fundamental value
CRUX	Europe ex UK	Long term, quality
SW Mitchell	Europe ex UK	Unrecognised value
Matthews	Asia	Income focus
GQG Partners	Emerging markets	Quality at reasonable price
Witan	Direct holdings	Specialist funds, value

Source: Numis, Witan

By **Daniel Coatsworth**
Editor

Finding the best return on cash with minimal risk

We look at the best rates on the market and investment fund alternatives

Cash is king, so the saying goes. Many people want to have a decent cash pile to hand, for a future purchase or a rainy day fund.

What's more, some people will find they temporarily have a large chunk of cash they want to keep safe before spending it or investing it – those who've sold a house but are yet to buy their next property, or those who've come into a sizeable inheritance, for example.

But what's the best return you can get on your cash with minimal risk? It depends on how much access you want and how long you'll have until you need to use your money.

If you have sizeable sums to save then make sure you're going to be protected, or you might need to split it between various providers (see the box later).

I WANT ACCESS WITHIN THE YEAR

If you only want your money locked up for a year, for example, when you plan to buy your next property, you'll get less interest than if you lock up the money for longer.

Those who aren't sure when they'll want access can get 1.5% with Marcus, the new brand from Goldman Sachs. This rate includes a 0.15% bonus, which is whipped away after 12 months, at which point you'll need to see if you can get a better rate with another account.

You open the account online and can invest up to £100,000, but you can withdraw money whenever you want. So at this rate on a £50,000 investment you'll get £750 in interest after a year.

If you're willing to lock up cash for one year and not have any access to it, you can boost this return to 2.2%, with the one-year bond from Bank of London and The Middle East.

This isn't strictly an interest rate, as the bank operates under Islamic finance rules, so it's an expected profit rate. On £50,000 that would give you £1,100 a year in interest.

If that feels a bit complicated to you, you can get 2.03% from Atom Bank, which is an app-only bank. If you want a simpler account that you can open in branch, Metro Bank pays 2% on its one-year bond.

I'M WILLING TO TIE IT UP FOR THREE YEARS

If you tie up for longer you get more in interest – because the bank knows it can rely on your cash for a longer period.

By locking up the money you're assuming that interest rates won't shoot up dramatically in the intervening period. Likewise, if you take the view that rates are going to rise in the next year, and so you stick with a one-year account, you're at risk of interest rates falling and getting a lower rate when you come to switch accounts in a year's time.

For a three-year fixed rate account you can get 2.52% with

Al Rayan Bank, which operates to the same aforementioned Islamic finance rules, and needs £1,000 to open it. You can't make withdrawals on this account during the savings period. For a bank not under Islamic finance rules, your best bet is Tandem Bank's three-year fixed saver account, which pays 2.4% on up to £2.5m.

I'M WILLING TO TIE IT UP FOR FIVE YEARS AND TAKE MORE RISK

If you know you won't need access to the money and you're willing to move out of cash accounts and into bonds, you could earn a bit more money, depending on market conditions.

The top five-year fixed rate cash account pays 2.75%, with Bank of London and The Middle East, or 2.65% with Secure Trust Bank.

If you want to beat these rates via investing, you need to be fairly confident that you're going to earn more in the bond market to make it worth the extra risk.

> "YOU NEED TO BE FAIRLY CONFIDENT THAT YOU'RE GOING TO EARN MORE THAN (CASH SAVINGS RATES) IN THE BOND MARKET TO MAKE IT WORTH THE EXTRA RISK"

Funds will help to spread the risk, as they will be able to buy up a number of bonds from different companies or governments, meaning that if one defaults it should only affect a small portion of their money.

One option is **Royal London Corporate Bond Fund (B3MBXC4)**, which had a yield over the past 12 months of 3.7%. The £1.3bn fund invests in a number of different company bonds, from HSBC and Lloyds to Thames Water, for a relatively low cost of 0.37%. Over the past five years it has delivered a total return (so price return plus income) of 18.2%.

Another option is **Allianz Gilt Yield Fund (3138339)**, which invests in UK Government bonds. These are typically considered to be safer than corporate bonds and so it has delivered a lower total return over the past five years of 11.2%, with a 12-month yield of 1.37%.

By **Laura Suter**
AJ Bell Personal Finance Analyst

What is my safety net?

THE FINANCIAL SERVICES Compensation Scheme will provide compensation if something happens to the bank or building society where you've got your money.

You're covered for £85,000 per person, per bank, building society or credit union – so if you have a joint account you're covered up to £170,000.

This means that ideally you don't want more than £85,000 with each provider, even if it's spread across different accounts. You also need to look out for different brands that are owned by the same institution, for example First Direct is owned by HSBC.

However, you could get higher protection for temporarily high balances. You get this protection up to £1m per person for up to six months based on certain events – the most common one is where you sell a house and have the money in cash for a short period.

Other reasons include an insurance payout or compensation, inheritance, a lump sum as a result of divorce, or a redundancy payout. You might have to provide some documentation to prove the reason for the temporarily high balance.

'Can you explain how flexi-access drawdown works?'

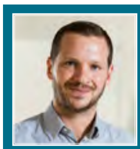
AJ Bell pensions expert Tom Selby explains the process

I understand I can take 25% of my SIPP as a tax-free pension commencement lump sum (I have no scheme specific protection in excess of 25%).

If I chose a flexi-access drawdown option, does the PCLS have to be taken as one payment before any of the remaining 75% potentially taxable pension is withdrawn, or could it be taken in intervals and if so are there any time limits on when it has to be taken by?

I'm hoping to move into part-time work earning approximately £8,500 gross which would mean I would have £4,000 of unused personal allowance. If I was looking to generate a total of £15,000 net income a year, could I designate £4,000 per year from the taxable element of my SIPP and then take £2,500 of tax free cash therefore and pay no income tax for the year?

Peter, aged 57



Tom Selby
AJ Bell
Senior Analyst says:

Most savers in defined contribution pension plans like SIPPs can access 25% of their fund tax-free from age 55.

There are broadly three options for obtaining retirement income: keep your money invested through drawdown; buy a guaranteed income for life (an

annuity); or take ad-hoc lump sums where 25% of each chunk is tax-free and the remaining 75% is taxed (referred to in the jargon as 'UFPLS').

In drawdown you'll be entitled to a quarter of your pot tax-free. For example, if you put £100,000 into drawdown you could take 25% without paying any tax. The remaining £75,000 would be taxed in the same way as income when you take it out of your SIPP.

If you don't want to take all your tax-free cash straight away you can choose to put your pot into drawdown in stages. In the example above, you could put a smaller portion into drawdown – say £10,000 – and receive 25% tax-free each time you do it.

There are no time limits if you do this and if your fund grows you could boost your tax-free cash pile. Equally, if it shrinks in value you'll get less.

It is possible to take a tax-free income in this manner as you suggest (provided these are your only sources of taxable income).

In your example, you could put £10,000 into drawdown and thus access £2,500 in tax-free cash. You could then draw £4,000 from the taxable portion of the fund (using up your full £12,500 personal allowance) to reach your £15,000 tax-free income target.

Accessing taxable income from your pot will trigger the Money Purchase Annual Allowance (MPAA), reducing the amount you can save tax-free in a pension each year from £40,000 to just £4,000.

You're likely to be overtaxed initially by HMRC, so you'll need to fill in a reclaim form to get your money back.

DO YOU HAVE A QUESTION ON RETIREMENT ISSUES?

Send an email to **editorial@sharesmagazine.co.uk** with the words 'Retirement question' in the subject line. We'll do our best to respond in a future edition of *Shares*.

Please note, we only provide guidance and we do not provide financial advice. If you're unsure please consult a suitably qualified financial adviser. We cannot comment on individual investment portfolios.

FEATURE

What do I need to know about pension transfers?

Freedoms have enabled you to make the most of your retirement pot but also added complexity

Pension freedoms introduced in 2015 have given people more control than ever before over their finances in retirement – but they have also created some confusion.

There are a number of different types of pension – you might have more than one – and it is not always clear which is the best option.

UNDERSTANDING THE PENSION LANDSCAPE

The two main types of workplace pension are known as defined benefit and defined contribution schemes. Defined benefit pensions are often referred to as final salary schemes. These tend to be older pension plans offered by big companies and the public sector and they are often incredibly valuable.

This is because they pay an income for life, which is linked to your final salary when you retired and the number of years you paid into the pension, regardless of stock market performance. They are so named because the benefit you get from the pension is clear.

With defined contribution schemes on the other hand, the amount you pay into the pension is very clear but what you will get out of it isn't. These are now the more common type of scheme and see individuals

and their employers pay into a pension over the course of their working life.

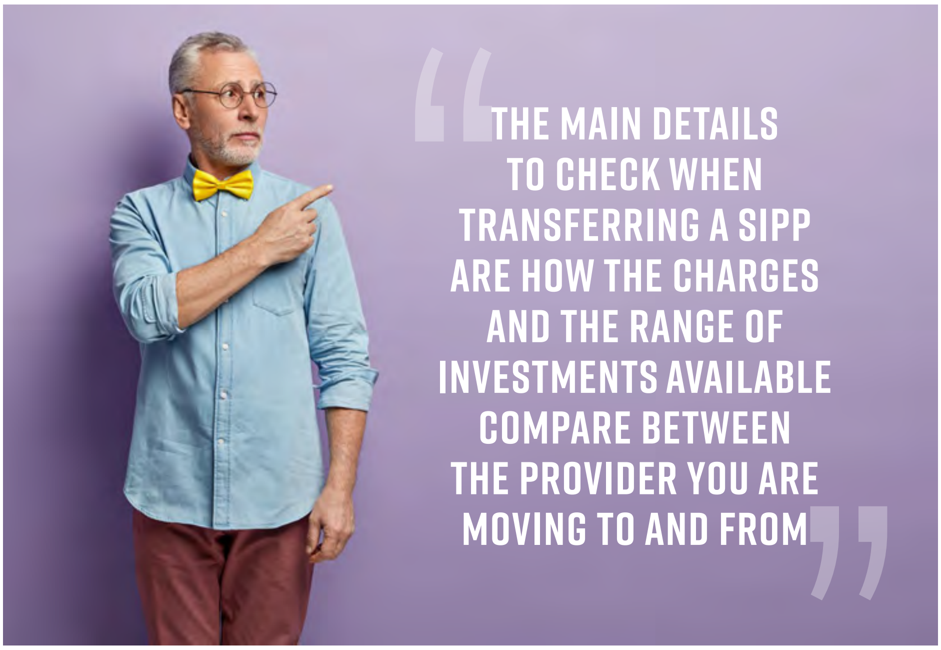
How much is accrued over that time depends not just on your contributions or how long you worked but on the performance of the stock market and the investments into which you have saved. At the point of retirement, you can either use the money that has been built up to buy an annuity, giving you an income for life, or keep it invested and drawdown regular or ad hoc sums from the pot.

Regardless of which type of pension you currently save into, the likelihood is that you have a number of pension pots. The concept of a job for life is a rare one these days and the average adult is likely to have at least six different jobs during their working life, and just as many different pension pots.

An obvious first step when you change career is to take your pension savings with you and, if you have lost track of old schemes, to track them down. Steve Webb, director of policy at Royal London, says: 'If someone has multiple personal pension pots and perhaps some are not performing well or have high charges, then consolidation could be the right answer.'

CONSOLIDATING YOUR RETIREMENT FUNDS

If all of your pension schemes



are defined contribution then this is often a sensible strategy. Consolidating all of your pensions into one scheme can be done quickly and easily, and makes it simpler to keep on top of your savings. All you need to do is fill in a form with your current pension provider, giving it the details of your other plans and permission to move them, and it does the rest.

Usually, the old scheme will sell the investments you hold and put your money into cash, which is transferred to the new provider and then invested.

Sometimes there is the option to transfer your money while it is still invested, known as in-specie, but this might incur additional charges. How long a transfer takes will vary greatly depending on the provider and the technology they use – some transfers can take as little as two weeks while some may take up to 12 weeks.

Transferring a Self-Invested Personal Pension (SIPP) should also be a relatively simple affair. These are pension plans you set up and manage yourself and are often used as a top-up to existing pension savings or by those who are self-employed.

The main details to check when transferring a SIPP are how the charges and the range of investments available compare between the provider you are moving to and from.

The usability of the website or app and customer service are also key factors to bear in mind when you are managing your own investments. In-specie transfers are more widely available between SIPPs but providers may charge per investment you move – AJ Bell Youinvest, for example, charges £25 per investment – which can rack up if you are transferring an entire portfolio.

This may mean that selling your investments and moving the money as cash may be cheaper, however you do risk having time out of the market and the potential of having to buy back your investments at a higher price if they have risen in that period.

DEFINED BENEFIT SCHEMES MORE DIFFICULT TO DEAL WITH

Transferring defined benefit schemes is usually more complicated and taking financial advice before doing so is now mandatory if you have assets worth more than £30,000. These older-style schemes are not only more difficult to value but often have valuable benefits attached to them, such as spousal benefits, which you lose if you move the money elsewhere.

Webb adds: 'It's worth pointing out that there could also be similar issues regarding valuable guarantees attached to old defined contribution pots. Some older policies will have been sold with valuable guaranteed annuity rates attached to them, for example, which it is often unwise to throw away.'

Also, worth checking before your transfer any pension is whether the policy has an exit penalty if you transfer the money out, which could eat into your assets.

Ammo Kambo, financial planner at Brewin Dolphin, says other points to consider include the choice of funds available in your old and new schemes, to ensure you can invest the money as you wish, and how the charges compare. You should also check what the options are when you come to retirement, as some schemes might not allow drawdown, for example.

By **Holly Black**

The case for and against US stocks and shares

We examine the reasons to be cheerful and fearful on the American market

After all of the hullaballoo surrounding their flotations, most investors will be aware Lyft is in need of a boost and Uber is stalling immediately after their respective initial public offerings (IPOs).

Whether such huge deals 'call the top' or not remains to be seen, even if experienced investors may be looking back to some uncanny parallels with the final stages of the technology, media and telecoms bubble of 1998-2000.

This is because one wobbly week, owing to an escalation in the trade dispute between the US and China, leaves the S&P trading no higher than it did in January 2018, despite a 20%-plus rally from the December low and the S&P 500's attainment of a new all-time high of 2,946 on 30 April.

That overall lack of progress is quite surprising given the bullish tone which has characterised the US equity market for the last 17 months (and more) and chartists may be tempted to argue that a 'triple-top' pattern is emerging in the benchmark S&P 500 index.

Whether investors have any truck with technical analysis is up to them, but the current chart does at least give pause for thought, if you keep in mind the old adage that 'market tops are a process, market bottoms are an event'.

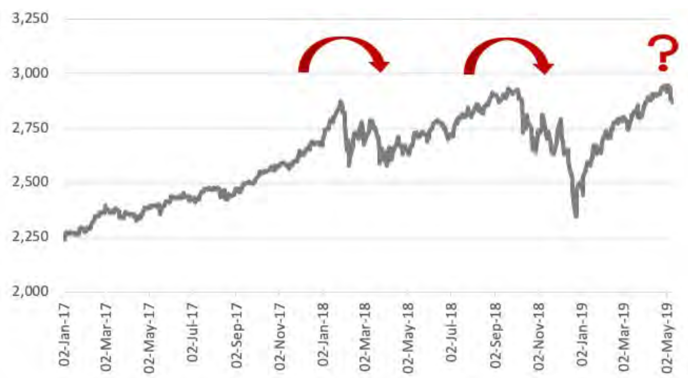
REASONS TO BE CHEERFUL

The US stock market has stumbled many times since it hit bottom in March 2009 and bulls of US stocks are unlikely to be concerned, especially as the S&P 500 trades within 2% of its recent new peak.

Supporters of US exposure will argue that American equities are far from excessively valued on around 18 times earnings for 2019, based on consensus analysts' forecasts, for three good reasons:

- The economy looks like one of the best performers in the Western World.
- US corporate earnings are forecast by analysts to rise 9% this year and 12% next year.
- The Federal Reserve is running very accommodative monetary policy, with interest rates held at just 2.5% (below the first quarter's annualised GDP growth rate of 3.2%) and quantitative tightening due to come to a halt in the autumn.

IS THE US EQUITY MARKET FINALLY RUNNING OUT OF PUFF AFTER A TEN-YEAR BULL RUN?



Source: Refinitiv

US CORPORATE EARNINGS ARE EXPECTED TO RISE AT A GOOD CLIP IN 2019 AND 2020

Source: Standard & Poor's

GROUNDS FOR CONCERN

There are counterarguments:

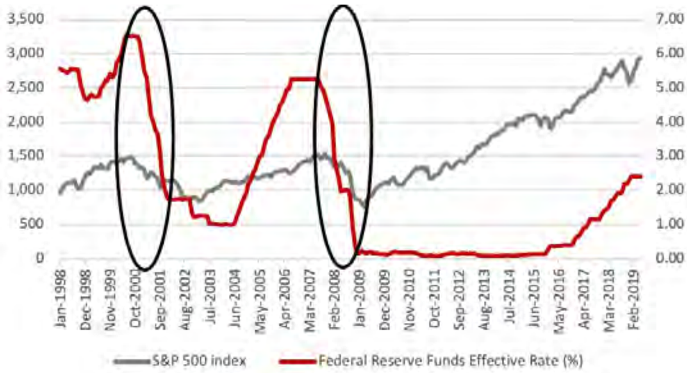
- Profit forecasts for 2019 are back-end loaded. Earnings growth is expected to surge from 3% to 4% year-on-year in the first three quarters to 26% in the fourth. Some allowance must be made for the base effect created by the December 2017 Trump tax cuts but this may be why markets think the trade talks with China are so important.
- If they go wrong, tariffs are applied, China retaliates and global growth slows then those second-half forecasts could look exposed and leave US stocks looking expensive.
- US corporate profits stand at a record high, so US stocks could start to look very expensive very quickly if there is a surprise economic slowdown or loss of momentum in corporate earnings growth.
- Also note that US corporate profits as a percentage of GDP peaked in 2012 to suggest that some margin pressure, in the form of wage growth, is already creeping in.
- Robert Shiller's cyclically-adjusted price-to-earnings (CAPE) ratio puts US stocks on 30 times earnings. They have only been more expensive twice in their history and those episodes – 1929 and 2000 – did not end well

SHILLER CAPE ANALYSIS SUGGESTS TOTAL RETURNS FROM US EQUITIES COULD BE MEAGRE IN THE YEARS AHEAD

Source: http://www.econ.yale.edu/~shiller/data.htm

for investors. Those who doubt Shiller's data argue that CAPE is a poor market-timing tool. In the short term they are right but on 10-year view lofty CAPE ratios have consistently warned of poor future returns.

BUYING ON THE FIRST US RATE CUT DID NOT WORK IN 2000 OR 2007



Source: Refinitiv

FINAL THOUGHTS

It is tempting when all else fails to rely on Federal Reserve, especially as the US central bank's policy U-turn in January, when it stopped promising higher interest rates, followed some hefty stock market falls.

But even a cursory glance at the 2000-03 and 2007-09 bear markets shows that the Fed cut rates aggressively and it initially made no difference. Share prices still collapsed because valuations were stretched, earnings were disappointing and the economy was tipping over.

Ultimately a bear market needs three things to start, if history is any guide:

- Rich valuations. These are arguably now prevalent.
- An economic slowdown. There is no sign of this as yet, but the Fed does seem twitchy.
- Earnings disappointments. The first quarter reporting season has been fine, but 2019 estimates rely on a big acceleration in the second half.

This means the July second quarter reporting season could be particularly informative as it is likely to set the tone for the rest of 2019 and some time beyond.

By **Russ Mould**
AJ Bell Investment Director

The ultimate guide to investing in the technology space: part 2

We look at a range of relevant stocks, funds and ETFs

In part one, we talked about the attractive growth dynamics of investing in technology. In part two we now discuss some of options for investors wanting exposure to tech themes.

Many investors already have exposure, even if they don't know it. A US or UK tracker fund would both give you a slice of tech. More than 29% of the S&P 500 index in the US is represented by tech stocks, although it runs to less than 1% of the FTSE 100.

It would be easy to suggest that Facebook, Amazon, Alphabet, Apple and Microsoft are the classic tech stocks to examine, yet the industry goes far wider and deeper.

Names like Salesforce, ServiceNow, Okta, SAP, Dassault Systemes, ASML, Tencent and Baidu are all multi-billion dollar companies with huge revenues and they are big hits with fund managers such as Walter Price at **Allianz Technology Trust (ATT)**, the Baillie Gifford team behind **Scottish Mortgage (SMT)** or Ben Rogoff, who runs the **Polar Capital Global Technology Fund (B42W4J8)**.

There are thousands of tech companies on the stock market ranging from pre-revenue start-ups to large giants.

EXAMPLES OF FUNDS WITH TECHNOLOGY EXPOSURE

- **Neptune Global Technology Fund (BYXZ5N7)**. Holdings include Microsoft, Twilio, Amazon and Visa.
- **Polar Capital Global Technology Fund (B42W4J8)**. Holdings include Alibaba, Advanced Micro Devices and Zendesk.
- **Standard Life Investments American Equity (B7JCD62)**. Holdings include Baxter International, Equinix and Boston Scientific.
- **Threadneedle American Select Fund (B7HJLD8)**. Holdings include Alphabet, LAM Research and Microsoft.

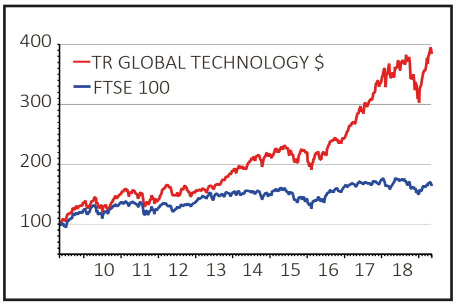
UK technology opportunities tend to sit towards the lower end of the market cap spectrum, including many listed on the AIM junior market. There are several funds which have exposure to the smaller end of the market including **Herald Investment Trust (HRI)** and **TB Amati Smaller Companies (B2NG4R3)**.

HOW HAS TECH BEING DOING?

The global technology sector has been one of the main driving forces of a 10-year global stock market bull run that is still going. For example, the MSCI World Information Technology index has beaten its MSCI World cousin eight years out of the past 10, rallying 345% since 2004, versus 184%.

The US tech-heavy Nasdaq has nearly doubled in five years (up 92%), almost twice the 51% of the more widely representative S&P 500. The FTSE 100 has gained less than 6% by contrast.

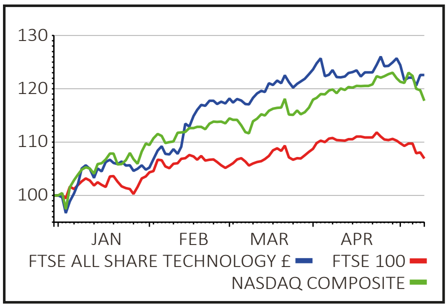
Tech stocks were hit pretty hard during the global markets



EXAMPLES OF INVESTMENT TRUSTS WITH TECHNOLOGY EXPOSURE

- **Scottish Mortgage (SMT).** Holdings include Amazon, Illumina, Tencent and Tesla**.**
- **Polar Technology Trust (PCT).** Holdings include Alphabet, Alibaba, Tencent and Adobe.
- **Herald Investment Trust (HRI).** Holdings include GB, IQE, Bango and Radware.
- **Murray International Trust (MYI).** Holdings include Taiwan Semiconductor, Taiwan Mobile and Verizon.

sell-off late in 2018 but the bounce back has been strong. Nasdaq is up 18% year-to-date, recovering those fourth quarter losses completely. It's similar in the UK with the technology part of the FTSE All-Share up more than 20% so far in 2019. That compares to a rather more dogged 7.1% of the FTSE 100.



DOESN'T THAT MAKE TECH EXPENSIVE?

Valuations can certainly become elevated, but usually for good reason. The price-to-earnings (PE) multiple of Amazon is around 78-times for 2019 but it has been consistently growing earnings at 40%.

Advanced Micro Devices, which designs clever microprocessors, is growing even faster, turning a $117m net income deficit into a $780m profit in just three years, if 2019 forecasts are on the money.

Shares in more mature tech companies trade on lower earnings multiples, many with copper-plated balance sheets, huge net cash and often paying handsome dividends. The forward PEs of Apple, Alphabet and Microsoft stand at 17, 27 and 29, respectively.

The story is no different with UK tech stocks where rapid growth today and the promise of significant profits down the line from disruptive business models, products and intellectual property can mean eye-popping valuations.

Software robots supplier **Blue Prism (PRSM:AIM)** is valued at £1.33bn yet has never made a profit, but investors are not buying today's opportunity, they are investing for the future potential.

In comparison, mature accounting software firm **Sage (SGE)** has a long track record of more modest but profitable growth and its 2019 PE is around 25.

PLAYING THE LONG GAME

A longer-term horizon is required for much of the technology space. Yet this is one of the few investment spaces with strong

MAJOR TECH THEMES

- **Cloud computing**
- **Artificial intelligence**
- **Automation and robotics**
- **Complex microprocessors**
- **Software-as-a-service**
- **Digital payments**

Source: Polar Capital

secular growth drivers as the world increasingly embraces digital everything. Innovation is constant and that makes it rational for investors and markets to place a premium on the sector.

Investors might hark back to the dotcom crash in the early 2000s after such a strong run for the technology sector yet fund managers, in the main, have consistently called into question such comparisons. The major difference between now and then is real earnings and cash flow.

'This time round technology share prices are rising with earnings upgrades that are outstripping an otherwise low growth environment,' says Allianz's Walter Price.

EXAMPLES OF ETFS WITH TECHNOLOGY EXPOSURE

- **Lyxor Russell 1000 Growth UCITS (RSGL)**
- **Invesco Technology S&P US Select Sector UCITS (XLKQ)**
- **WisdomTree Artificial Intelligence UCITS (INTL)**
- **First Trust Cloud Computing UCITS (FSKY)**

By **Steven Frazer**
News Editor

5 WAYS TO PLAY THE TECH SPACE

- **Amazon (AMZN:NDQ) $1,899.87 BUY**
  This is arguably the best tech and growth company in the world. Everyone knows how it has disrupted the retail industry but less well known is its soaring power as a cloud service provider, now a $25bn-odd part of the business and growing fast. Technology like personal assistant Alexa, TV and music streaming, checkout-less stores and drone delivery are just some of things it is working on.

- **Craneware (CRW:AIM) £27.60 BUY**
  This is a UK rarity that dominates a niche market supplying hospitals in the US with its technology. Its toolkits directly save millions of dollars for health providers through analytical pricing, coding and charging of health services. Overseas market opportunities will likely come in time but for now US growth is keeping it busy.

- **Polar Capital Global Technology Fund (B42W4J8) £37.87 BUY**
  Collectives are often about how the quality of the management team and Polar boats a number of tech experts, headed by Ben Rogoff, who have a proven track record for value creation.

  Spotting long-run technology themes and backing the best companies within that sphere is the remit, but we also like Polar's willingness to adapt the portfolio as market dynamics change and embrace new equity opportunities.

- **Allianz Technology Trust (ATT) £15.86 BUY**
  Forty five years of technology industry experience speaks for itself. Allianz manager Walter Price was analysing tech companies and picking the best through the personal computing breakthrough of Windows, the dotcom crash, the explosion of smartphones, and now into the digital fourth industrial revolution.

- **SPDR MSCI World Technology (WTEC) $55.96 BUY**
  This exchange-traded fund (ETF) is a great option to capture the potential future growth of the wider technology industry. From Silicon Valley to the most exciting tech firms in emerging China, this ETF acts a very good one-stop shop for investors wanting to back technology in the very broadest sense.

Battle of the broadcasters: why is STV beating ITV?

We look at the strategy behind the Scottish TV company

What is **ITV's (ITV)** counterpart north of the border getting right that its former parent is getting wrong?

Both are under relatively new management and Carolyn McCall at ITV and Simon Pitts at **STV (STVG)** arguably face the same challenges of a difficult consumer backdrop and political uncertainty with all the implications that has for advertising revenue.

Yet in the past 12 months shares in STV are up nearly 10% while ITV is down more than 17%.

STV IN A NUTSHELL

STV was formed through a combination of Grampian Television and Scottish Television in 2006 and now holds the Channel 3 (ITV) commercial television licence for Scotland.

From its base by the banks of the Clyde in Glasgow it creates and distributes programmes across all platforms including broadcast, catch-up TV, online, mobile and other connected devices.

Pitts, who replaced Rob Woodward in January 2018, is an

The Victim: an STV production

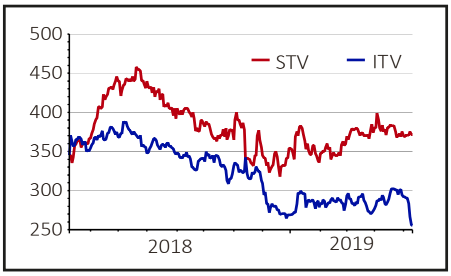
alumni of ITV. In some respects, the strategy is not too dissimilar to his former employer.

STV is looking to diversify away from more volatile TV advertising revenue by investing in TV production and building up its digital footprint. Pitts tells *Shares*: 'These days you don't have a digital strategy, you just have a strategy.'

The company has one public key performance indicator, which is to achieve a third of total operating profit from non-broadcast activities by 2020. In 2018 the total was 24%, up from 19% in 2017.

A LOCAL HERO?

One element of the strategy which seems distinct from ITV is a more localised focus,



particularly when it comes to advertising. The aim is to penetrate parts of the advertising market which historically would have gone to local newspapers or commercial radio.

This was part of the plan under Pitts' predecessor Rob Woodward. He hit upon the idea of city-based channels in Scotland's major cities, which were eventually subsumed into one channel STV2.

Unfortunately this failed to find an audience and was loss-making. Pitts closed the channel down shortly after taking over, with the advent of BBC Scotland – a rival launch from the public service broadcaster – perhaps a factor in the decision.

Pitts' play for local advertising has been supported through the STV growth fund – starting with seed capital of £5m in May 2018, this was doubled in February 2019. The fund aims to help businesses, 130 of them so far, to advertise on TV, many for the first time.

This includes matched funding for TV ad campaigns, free advertising for start-ups and, for some consumer-facing businesses, even ads in return for revenue or equity sharing agreements.

Pitts makes clear the company has no interest in becoming a venture capital fund and acknowledges the motive isn't pure altruism but instead lies in securing more advertisers for STV in the long term.

Looking at the recent trading update this appears to be paying off, with regional advertising up between 20% and 25%.

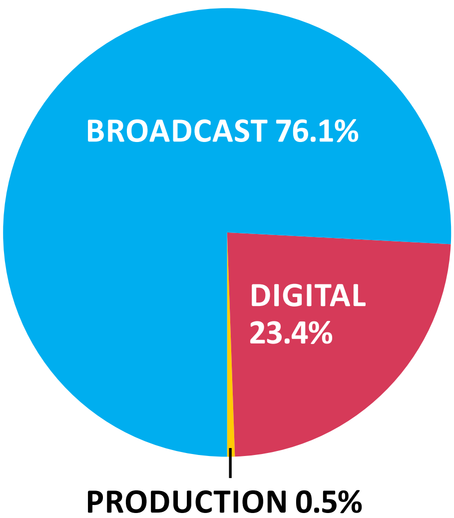
National advertising revenue was expected to be ahead of previous guidance, falling by between 1% and 2% compared with a 7% drop at ITV.

WORKING WITH THIRD PARTIES

STV benefits from a favourable deal with ITV, struck in 2012 after a long-running dispute between the two parties, which insulates STV from both declines in the national advertising market and increases in the ITV programme budget. This lasts until 2024.

Agreements secured with Virgin Media and Sky in the past

STV operating profit



12 months means the STV Player is now available on all platforms across Scotland.

Pitts notes the company has added new programming to the STV Player to help it compete with the likes of Amazon and Netflix including shows like *In the Night Garden* and coverage of European football. He dismisses suggestions this move could dilute the STV brand.

SMOOTHING LUMPY PRODUCTION REVENUE

On the production side there was a recent breakthrough moment with its first big multi-part drama on BBC1 called *The Victim*.

The problem is, as ITV has found, production revenue tends to be unpredictable or lumpy. To address this situation STV has to get bigger.

That explains why it has made several high-profile new hires in its production business including drama executive Elaine Collins, who was behind successful shows like *Vera* and *Shetland*, and former BBC commissioning editor Craig Hunter who green-lit programmes like *Blue Planet Live* and *Inside the Factory*.

Shore Capital analyst Roddy Davidson lays out what he sees as the key qualities of the business as being: '(a) STV's position as the dominant commercial broadcaster (and go-to solution for TV advertising in Scotland) and its consistent outperformance of the ITV network; (b) the strength and experience of its management team and; (c) the potential to drive digital and content revenues.'

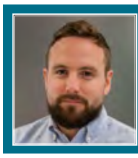
At 375p and based on Davidson's forecasts for 2019 STV's shares trade on a price-to-earnings (PE) ratio of 8.1-times and yield 5.6%, with a recent agreement on its pension commitments helping to underpin the dividend.

BUYBACK PRESSURE

Perhaps this single-digit PE is why activist shareholder **Crystal Amber (CRS:AIM)**, which owns nearly 18% of the company, is keen for management to pursue share buybacks. Pitts says in response there is a requirement to 'balance the needs of all shareholders'.

And despite an apparent rebellion against his own pay award at the company's recent investor meeting (23 Apr), with 30% voting against the remuneration report, Pitts says shareholders are 'very supportive'.

The discounted valuation has also inevitably driven takeover speculation with ITV itself a mooted bidder, but Pitts is also firm in his belief the company has 'a successful future as an independent business'.



By **Tom Sieber**
Deputy Editor

KEY

- Main Market
- AIM
- Investment Trust
- Fund
- Exchange-Traded Fund
- Overseas share

KEY ANNOUNCEMENTS OVER THE NEXT WEEK

Full year results

21 May: Assura, Bloomsbury, Big Yellow, Cranswick, Electrocomponents, First Derivatives, Halfords, Homeserve, Severn Trent. **22 May:** Babcock, Great Portland Estates, HICL Infrastructure, Intermediate Capital, Marks & Spencer, Pets At Home, Royal Mail, SSE. **23 May:** Dairy Crest, Helical Bar, Mediclinic International, PayPoint, TalkTalk, Tate & Lyle, United Utilities.

Half year results

17 May: EasyJet, Future, Sage. **21 May:** Renew, Shaftesbury, Topps Tiles, UDG Healthcare. **22 May:** Britvic, Paragon Banking **23 May:** AJ Bell, Hollywood Bowl, Mitchells & Butlers.

Trading updates

17 May: Hikma Pharmaceuticals. **21 May:** Galliford Try, Provident Financial, WH Smith. **22 May:** Close Brothers, IG. **23 May:** Coats, Essentra, Inchcape, Intertek.

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